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# Risk of Loss in Bank Collections Under North Carolina Statute

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It is probable that the Court will not adhere to its distinction between presumptions imposing the risk of non-persuasion and those merely shifting the duty of proceeding with the evidence. If it continues to require that statutory presumptions be based upon a "rational connection," it will doubtless extend this same requirement to statutes shifting the mere duty of going forward with the evidence.<sup>25</sup> It is hoped, however, that it will do neither, but will adopt the more liberal attitude of holding every type of statutory presumption valid where absolute liability could be imposed in the same situation,<sup>26</sup> and, where absolute liability could not be imposed, of holding a statutory presumption valid if it is based either upon a "probable connection" or some authorized reason of policy.<sup>27</sup>

J. FRAZIER GLENN, JR.

#### RISK OF LOSS IN BANK COLLECTIONS UNDER NORTH CAROLINA STATUTE

As an emergency measure, North Carolina, together with a number of other states, enacted a statute<sup>1</sup> permitting a drawee bank to

<sup>25</sup> A statute making failure to perform labor contracted for without refunding the money paid therefor prima facie evidence of criminal intent was declared unconstitutional although it was construed as meaning just enough evidence to go to the jury from which they could find for either party. *Bailey v. Alabama*, *supra* note 1. This case seems to indicate the importance placed upon a probable connection by the Supreme Court of the United States.

<sup>26</sup> This attitude was adopted by the U. S. Supreme Court in *Ferry v. Ramsay*, *supra* note 5.

<sup>27</sup> Since the completion of this note, and after the United States Supreme Court's decision holding the Georgia statute unconstitutional, *supra* note 4, the Court of Appeals of Georgia held this same statute *constitutional* on the ground that the U. S. Supreme Court had erroneously construed the statute as shifting the risk of non-persuasion when its proper construction, indicated by a long line of decisions, merely required the railroad company to proceed with the evidence. *Ga. Ry. and Power Co. v. Shaw*, 149 S. E. 657 (Ga., Oct. 1929). The constitutionality of this decision will be the subject of a comment in a forthcoming issue of this LAW REVIEW.

It should be noted that the Georgia legislature, immediately after and apparently as a result of the decision in the Henderson case, *supra* note 4, passed an act approved August 24, 1929, which creates a presumption of negligence against a railroad company in the words of the Mississippi statute, held constitutional in *Mobile, etc. R. R. v. Turnipseed*, *supra* note 13.

<sup>1</sup> N. C. Code 1927, §220 (aa) as enacted by N. C. Pub. Laws 1921, Ch. 20, §2. In order to prevent the accumulation of unnecessary amounts of money in the vaults of the banks and trust companies chartered by this state, all checks drawn on said banks and trust companies shall, unless specified on the face thereof to the contrary by the maker or makers thereof, be payable in exchange drawn on the reserve deposits of said banks, when any such check is presented by or through any Federal Reserve Bank, postoffice or express company or any respective agent thereof. Held constitutional in *Farmers' and Merchants' Bank of Monroe v. Federal Reserve Bank*, 262 U. S. 649, 43 S. Ct.

pay by exchange draft an item presented to it for collection, by or through a Federal Reserve Bank, postoffice or express company, unless the drawer had specified on the check to the contrary. The statute, directed only against the practices of the Federal Reserve Bank during the par-clearance controversy, had the desired effect.<sup>2</sup> Since then it has apparently lain dormant until recently, when two North Carolina cases<sup>3</sup> raised the question as to its effect upon the rights of the payee of a check, (1) against the drawer, (2) against the collecting bank,<sup>4</sup> when a drawee bank in the exercise of the option granted it, remits in payment of an item, an exchange draft which is dishonored upon presentation.

(1) *As to the payee's rights against the drawer.*

It is accepted as a general rule that a check is deemed paid, and the drawer and indorsers discharged when the item is stamped "paid" and debited to the drawer's account by the drawee.<sup>5</sup> The

651 (1923), reversing state court decision, 183 N. C. 546, 112 S. E. 252 (1922). Similar statutes have been enacted in other states: Ala. Gen. & Loc. Acts (1920), No. 35; Fla. Gen. Laws (1921), Ch. 8532; Ga. Laws (1920), p. 107; La. Acts (1920), No. 23; Miss. Laws (1920), Ch. 183; S. D. Laws (1921), Ch. 31; Tenn. Pub. Acts (1921), Ch. 37.

The following statutes permit collecting banks to forward items direct to the drawee and accept exchange in payment: Cal. Gen. Laws (1925), Ch. 312, §5; Colo. Laws (1925), Ch. 64, p. 172; Minn. Laws (1927), Ch. 138, §1; Mont. Laws (1925), Ch. 63, p. 85; Ore. Laws (1925), Ch. 207, §126; S. C. Laws (1927), No. 202, p. 369, having a section giving a preferred claim in the assets of an insolvent drawee bank; N. D. Laws (1927), Ch. 92 H. B. 249.

<sup>2</sup>In order to force par clearance upon numerous southern state banks the Federal Reserve Bank of Richmond made a practice of accumulating checks on those drawees and presenting them over the counter with a demand for cash. This resulted in a loss of income from collection exchange charges and necessitated keeping large amounts of currency on hand. See C. T. Murchison, *Par Clearance of Checks* (1922), 1 N. C. L. REV. 133; SPAHR, *CLEARANCE AND COLLECTION OF CHECKS* (1926), 232, 269 *et seq*; note (1923) 37 HARV. L. REV. 133.

<sup>3</sup>*Morris v. Cleve*, 197 N. C. 253, 148 S. E. 256 (1929) suit by holder of a check against the drawer; *Braswell v. Citizens Nat. Bank*, 197 N. C. 229, 148 S. E. 236 (1929) suit by holder against the collecting bank.

<sup>4</sup>For the purposes of clarity, reference in the text to "collecting bank" will be to the final bank in the chain of collection between the depository bank and the drawee. Since North Carolina follows the "Massachusetts rule" in regard to liability of collecting banks, *Bank of Rocky Mount v. Floyd*, 142 N. C. 187, 55 S. E. 95 (1906), the final collecting bank, for the purposes of the discussion, will bear the liability for loss due to non-payment of a check. For a discussion of the rule see note (1924) 13 CAL. L. REV. 231. See *infra* note 27.

<sup>5</sup>*Davidson v. Allen*, 276 Pac. 43 (Idaho 1929); *Baldwin's Bank v. Smith*, 215 N. Y. 76, 109 N. E. 138, L. R. A. 1918 F 1089. But see *Litchfield v. Reid*, 195 N. C. 161, 141 S. E. 543 (1928) discussed in note (1928) 6 N. C. L. REV. 466. From a review of the cases it would appear that under the noted situation the check is deemed paid only insofar as is necessary to hold the drawee liable by reason of his acceptance. *Ill. Trust and Sav. Bank v. Northern Bank*

debt of the drawee to the drawer is at that time discharged and the bank becomes the debtor of the payee. A drawer is also held to be discharged when a collecting bank accepts from a drawee bank, a draft in payment of a check forwarded by it for collection, even though such acceptance be unauthorized; upon the ground that the drawer, when he issues a check engages that it will be paid in money if duly presented, and acceptance of anything else is at the payee's risk.<sup>6</sup> The drawer assumes the risk of loss due to the drawee's default while the check is in the ordinary course of collection but the duration of his risk must not be extended without his consent. So, a drawer may be discharged from liability when the loss is the result of circuitous routing or delay in forwarding by an intermediate collecting bank, or by any acts which extend his liability beyond the time generally necessary to present a check and receive payment.<sup>7</sup>

Have these rules been changed by the statute permitting payment in exchange drawn on reserve deposits? It was held by the Federal Court in *Cleve v. Craven Chemical Co.*,<sup>8</sup> a case which squarely presented the question herein discussed, that the drawer was not discharged; that since the drawer had not specified upon the check that it be paid in cash, he impliedly agreed that, if the check should be presented by or through a Federal Reserve bank, the drawee might pay by exchange draft. So it would seem to follow that since the drawer's discharge was formerly due to the acceptance of a draft when money could have been demanded,<sup>9</sup> he should now be held to have consented to an extension of the period of his liability occasioned by the acceptance of an exchange draft in payment of the check.<sup>10</sup>

and Trust Co., 292 Ill. 11, 126 N. E. 533 (1920). *Quære*, however, whether a check would be paid so as to discharge the drawer when drawee made no remittance. *Nineteenth Ward Bank v. First Nat. Bank*, 184 Mass. 49, 67 N. E. 670 (1903); or when drawee revokes payment after finding drawer had insufficient funds. *Southern Stove Works v. Converse Sav. Bank*, 112 S. C. 230, 100 S. E. 75 (1919). See also *Boatwright v. Rankin*, 150 S. C. 374, 148 S. E. 214 (1929), to be discussed in a later issue.

<sup>6</sup> *Federal Reserve Bank v. Malloy*, 264 U. S. 160, 44 S. Ct. 296, 68 L. Ed. 617, 31 A. L. R. 1261 (1924); *Jensen v. Laurel Meat Co.*, 71 Mont. 582, 230 Pac. 1081 (1924).

<sup>7</sup> N. I. L., §186; *Sinclair Refining Co. v. Keith*, 98 Okla. 55, 221 Pac. 1003 (1923); *McEwen Bros. v. Cobb*, 104 Misc. Rep. 477, 172 N. Y. Supp. 44 (1918); but see *Empire-Arizona Copper Co. v. Shaw*, 20 Ariz. 471, 181 Pac. 464, 4 A. L. R. 1229 and note (1917).

<sup>8</sup> *Cleve v. Craven Chemical Co.*, 18 F. (2d) 711, 52 A. L. R. 980 (C. C. A., 4th, 1927).

<sup>9</sup> *Infra* note 22.

<sup>10</sup> *Tarasek v. Kosciuszko Bldg. and Loan Assn.*, 218 Ill. App. 484 (1921), holding drawer not discharged by delay in presentation when such delay is induced by the drawer's request.

There is appealing force in the argument, especially since the apparent effect of the holding is to further protect the payee. As a matter of fact, it is the drawer who has chosen the bank on which the check is drawn and which he has trusted with his money. The payee generally knows nothing of the bank and in taking the check for value places his confidence in the drawer rather than the bank. One is less likely to accept the check of a stranger drawn upon the strongest bank in the country than that of a known responsible drawer, upon a bank known to be weak.

The North Carolina court, however, upon facts identical with those in the case referred to above, held that the drawer was discharged; that since the statute was in derogation of the common-law it should not be extended by implication in that direction further than indicated by its terms. The expressed purpose of the statute discloses no intention to deal with the rights and liabilities of the parties to an instrument. It was also urged that the choice of the agency for presentation rests with the payee<sup>11</sup> and that his selection of a Federal Reserve bank carried with it the authorization to accept an exchange draft in payment.

It is submitted that the result reached by the North Carolina court is practically more desirable.<sup>12</sup> First, to hold the drawer liable necessitates an extension of the law merchant to a point it did not previously reach in order to meet a situation arising unexpectedly from the operation of the statute. Actually the practice here condoned is merely what has been the overwhelmingly common usage and custom for a long time, namely, the payment of collection items by drafts.<sup>13</sup>

<sup>11</sup> Theoretically it may be said that the choice does rest with the payee. He may send a messenger and have it collected over the counter, but when his depository bank is once engaged to collect the item, the payee has neither choice nor knowledge as to its presentation.

<sup>12</sup> Apparently this suggestion has been elsewhere controverted. *Jensen v. Laurel Meat Co.*, *supra* note 6, held the drawer discharged as in the principal case. In immediate repudiation of such result the Montana legislature passed an act holding the drawer liable, but failing to state for what length of time. *Mont. Laws* (1925), Ch. 65, S. B. 57. See note (1929) 4 *WASH. L. REV.* 39. Wyoming in 1923 passed an act holding the "maker" liable until final actual payment to the collecting bank. *Wyo. Laws* (1923), Ch. 84, p. 1 and 2, which right of action arising would normally become that of the payee's by subrogation. *Graham v. Warehouse*, 189 N. C. 533, 127 S. E. 540 (1925). In 1925 an entirely new banking law was enacted, *Wyo. Laws* (1925), Ch. 157, §47, from which the above maker's liability clause was omitted. It was again reinstated, however. *Wyo. Laws* (1927), Ch. 100, §47.

<sup>13</sup> See *LANGSTON AND WHITNEY, BANKING PRACTICE* (1921), pp. 102-3; 1 *KNIFFIN, COMMERCIAL BANKING* (1923), pp. 374-76; *Noble v. Doughten*, 72 Kan. 336, 83 Pac. 1048, 3 L. R. A. (N. S.) 1167 (1905); note (1924) 24 *Col. L. Rev.* 903.

Secondly, if the drawer's liability is to be extended to protect the payee in the case discussed, at what point in the course of collection shall we discharge the drawer and hold that the check is paid? Certainly we cannot hold him until actual cash is finally received by the payee or his depository bank. Under the credit basis of modern banking his liability might be extended over an indefinite and often unreasonable period.<sup>14</sup> In truth, in the majority of banking transactions money is never transferred at all. Shall we hold him until the collecting bank has had an opportunity of accepting something in payment of the remitted exchange draft? Such solution would afford the payee little or no protection that he does not now have and would not justify the promulgation of a rule, rather arbitrary in legal contemplation and probably attended by the addition of a few more parties to collection controversies.

Lastly, since North Carolina now has a statute<sup>15</sup> giving the payee a preference in the assets of the insolvent drawee it is quite probable that a claim against the drawee is of more value than one against a drawer who refuses to pay a debt, which, to speak as a layman, is not actually paid. It is almost unheard of, that an insolvent bank does not have sufficient funds to pay its preferred claims. By filing a claim with the receivers a payee would be assured of payment within a much shorter time than that required for a suit against the drawer.

(2) *As to the payee's rights against the collecting bank.*

The question presented in the Braswell case<sup>16</sup> is whether or not, under the statute, the collecting bank is relieved of the liability it formerly had, for accepting a bank draft in payment of a check forwarded by it for collection, when such draft is not paid upon presentation.

An agent is liable to his principal, in the absence of an agreement to the contrary, for the loss occasioned by his acceptance of anything other than money in payment of a check.<sup>17</sup> And this rule applies to collecting banks.<sup>18</sup> It is based upon the assumption that a check is

<sup>14</sup> SPAHR, *CLEARING AND COLLECTION OF CHECKS* (1926), pp. 189, 462 *et seq.*

<sup>15</sup> N. C. Code (1927), §218 (c), subs. 14.

<sup>16</sup> *Supra* note 3.

<sup>17</sup> 1 MECHEM, *AGENCY* (2d ed., 1914), §946.

<sup>18</sup> *Federal Reserve Bank v. Malloy*, *supra* note 6; *Jensen v. Laurel Meat Co.*, *supra* note 6; but see *Bank of Memphis v. Bank of Clarendon*, 63 Tex. Civ. App. 469, 134 S. W. 831 (1911) where collecting bank is held justified in accepting exchange draft in payment by reason of prevailing custom and usage. *State v. Tyler County State Bank*, 277 S. W. 625, 627, 42 A. L. R. 1347 and note (Tex. Civ. App. 1925). For discussion of custom and usage as affecting collecting bank's liability see note (1924) 24 COL. L. REV. 903.

payable in cash and the agent accepts payment in any other medium at his own risk.

In the *Braswell* case<sup>19</sup> Connor, J., says that the payee must be held to have authorized acceptance of a draft since he must have known that the collecting bank would avail itself of the postoffice as a means by which presentment would be made.<sup>20</sup> Therefore the payee cannot hold the bank liable. It has been held that the North Carolina statute does not change the rule that a check is payable only in cash.<sup>21</sup> Why should it not then follow that the collecting bank is authorized to present the check only in such manner as will enable it to demand cash?<sup>22</sup> A strong argument advanced in *Morris v. Cleve*<sup>23</sup> is that statutes in derogation of the common-law must be strictly construed under the limitation that the legislature will be presumed not to intend innovations upon the common-law, further than is indicated by their express terms. In the case of the *Federal Reserve Bank v. Malloy*,<sup>24</sup> where the plaintiff contended that a statute permitting forwarding direct to the drawee, also by implication carries with it the

<sup>19</sup> *Supra* note 3.

<sup>20</sup> *Infra* note 22.

<sup>21</sup> *Farmers' and Merchants' Bank v. Federal Reserve Bank*, *supra* note 1; see *Dewey v. Margolis*, *infra* note 22.

<sup>22</sup> In an admirable brief of the plaintiff appellant in the *Braswell* case it was forcefully argued that the statute permitting payment by draft was inapplicable. The check in that case had not been routed through the Federal Reserve Bank but had been sent by mail direct to the drawee by the collecting bank. The contention was that there was no presentment by the postoffice. Where a check is mailed direct to the drawee, it is held that the drawee is the agent for the purpose of presenting to itself. *Smith v. Mitchell*, 117 Ga. 772, 45 S. E. 47; note (1927) 52 A. L. R. 1001. It is obvious therefore that the court reached its result by construing this as presentment, "through" the postoffice. It must be admitted that the word "through" in the statute was not merely repetitious but was actually intended. Otherwise the Federal Reserve might have avoided the statute by forwarding items to another bank with instructions to present over the counter and demand cash. Since North Carolina follows the "Massachusetts rule" the presenting bank would be the agent of the payee to present and not of the prior bank in the chain of collection, and the above transaction would not be included in the phrase, "or any respective agent thereof." But if the foregoing is true it must follow that a check comes within the operation of the statute if it at any time in the course of collection comes into the hands of the postoffice. That such result was not intended by the legislature cannot be denied. See *Dewey v. Margolis*, 195 N. C. 307, 311, 142 S. E. 22 (1928), where when a check was presented as in the *Braswell* case, the court says, "It (the collecting bank) had the right to demand that the check of the defendants be paid in money. It waived this right at its own risk and not at the risk of the defendants." See also *Quarles v. Taylor*, 195 N. C. 313, 142 S. E. 25 (1928); *Farmers' and Merchants' Bank v. Federal Reserve Bank*, 262 U. S. 649, 658, 659, *supra* note 1.

<sup>23</sup> *Supra* note 3.

<sup>24</sup> *Supra* note 6.

authority to accept a draft in payment, the court said, "But to justify an extension by implication of the terms of the regulation, it must be made to appear at least that the addition sought to be annexed is a necessary means to carry into effect the authority expressly given by the regulation." Accordingly, the inquiry becomes, does a statute authorizing the drawee to pay checks by exchange drafts in certain instances, carry with it the authority for a collecting bank to take such a course of collection as will force it to accept such payment?

It is submitted that it does not unless all possible methods of presentment come within the operation of the statute.<sup>25</sup> In view of the present turbid state of the laws pertaining to bank collections, the result of the varied constructions and interpretations advanced in the clash between statutory enactments and the law merchant, it would probably be wise to leave it to the legislature<sup>26</sup> to provide for the result reached in the instant case.<sup>27</sup>

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<sup>25</sup> It is said that if two or more courses of collection are open to a collecting bank, one of which may prove damaging to the payee, the bank is liable if damage does result from pursuing that course. *Federal Land Bank v. Barrow*, 189 N. C. 303, 309, 127, S. E. 3, 6 (1925). But see *supra* note 22. Apparently the only course of collection open not affected by the statute is to send the check by a personal agent, a practice so obviously inconceivable as to be humorous. The net effect of the deductions referred to is to make checks drawn on banks in this state non-negotiable by reason of their being payable in something other than cash. It may be argued that since it is still possible at all events to require payment in cash that negotiability has not been destroyed. Yet the doctrine of negotiability is a child of the law merchant which has as its foundation the practices of the commercial world. It cannot therefore be defined in terms foreign to commercial practice. See Note (1923) 33 YALE L. J. 752, 759, fn. 23.

<sup>26</sup> The American Banker's Association's proposed Bank Collection Code has now been adopted in the following states: Ind. Acts (1929), Ch. 164; Md. Laws (1929), Ch. ....; Mo. Laws (1929), p. 205; Neb. Laws (1929), Ch. 41; N. J. Laws (1929), Ch. ....; N. M. Laws (1929), Ch. 138; N. Y. Laws (1929), Ch. 589; Wash. Laws (1929), Ch. ....; Wis. Laws (1929), Ch. ....

One of the interesting changes effected by the Act is to introduce the "Massachusetts rule" into New Jersey, New York, New Mexico and Wisconsin, states which formerly followed the "New York rule" of collecting bank liability.

(a) §350 (f) of the N. Y. statute reads: "When an item is received by mail by a solvent drawee or payor bank it shall be deemed paid when the amount is finally charged to the account of the maker or drawer." §350 l (2) contains: ". . . after having charged such item to the account of the maker or drawer thereof or otherwise discharged his liability thereon. . . ." Yet Mr. Brady, editor of the BANKING LAW JOURNAL, observes that in a case such as is discussed in the text the drawer remains liable, under §350 j. See (1929) 46 B. L. J. 755. The Code as adopted by Missouri does not have a section corresponding to §350 f of the N. Y. statute. The Committee on Uniform Act on Collection by Banks are at work on a Bank Collection Act which it is hoped will remedy the deficiencies of the Bankers Association Code.

<sup>27</sup> The effect of a contrary decision had it been reached in the *Braswell* case would immediately have been avoided by banks by the use of deposit slip